

Section 6

Earned Income Tax Credit (EITC)

Earned Income Tax Credit (EITC) Still Available for Working Taxpayers

The EITC is a tax credit for over 19 million lower-income working taxpayers. There are significant changes to the EITC tax law for the 2002 tax year.

The EITC is a refundable tax credit for people who work and have earned income from employment or self-employment below established amounts. Dollar amount limitations are adjusted for inflation each year. The credit reduces the amount of taxes owed and may also provide a refund. The EITC is available to anyone who qualifies for the credit and files a federal income tax return (even if no tax is due).

To qualify for the EITC, taxpayers must have earned income during the year. Married taxpayers who file a joint return may qualify if at least one spouse has earned income. Earned income includes all income from self-employment and wages. Some taxpayers may be eligible to claim the EITC for the first time, especially if there were changes in the family such as a new child, divorce, or decrease in earnings during the past year.

To claim the EITC, all taxpayers must meet the qualifications below :

- Must have a valid Social Security Number (SSN) issued by the Social Security Administration (SSA);
- Cannot file as “married filing separately;”
- Generally, must be a U.S. citizen or resident alien all year;
- Cannot file Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion;
- Cannot have investment income in excess of \$2,550; and
- Cannot be a qualifying child of another person.

A corrected and valid SSN must be provided for each qualifying child listed on Schedule EIC, unless the child was born and died during the tax year. File [Form SS-5](#) with the SSA if an SSN is needed.

EITC – Important Changes for Tax Year 2002

- **New definition of earned income:** For tax years beginning after 2001, earned income will no longer include nontaxable employee compensation.
- **Elimination of modified adjusted gross income (AGI):** For tax years beginning after 2001, taxpayers will no longer need to figure modified AGI. The EITC will be figured using AGI, *not* modified AGI.
- **New rules for taxpayers claiming the same qualifying child (tie-breaker rule):** For tax years beginning after 2001, the tie-breaker rule **only** applies if more than one taxpayer claims the same qualifying child. New rules will be used to determine which person can claim the EITC using that child.
- **Reduction of EITC by Alternative Minimum Tax (AMT) eliminated:** For tax years beginning after 2001, the taxpayer's EITC will no longer be reduced by the amount of any AMT shown on the return.
- **New definition of eligible foster child:** For tax years after 2001, the definition of an eligible foster child will change. The child will have to live with you only for more than half of the year, instead of the whole year.

The changes above can be found in Publication 553, Highlights of 2001 Tax Changes. In addition, for tax years beginning after 2001, the income amounts at which the phase-out begins and ends will increase by \$1,000 for joint filers.

The IRS Web site at www.irs.gov and tax instruction booklets contain more information on this credit. [Publication 596](#), Earned Income Credit, is available from the Web site under the Forms and Publications Finder or by calling 1-800-TAX FORM (1-800-829-3676).

Advance Earned Income Tax Credit (AEITC)

The AEITC is available for some individuals who qualify for the EITC. It allows them to get part of the credit throughout the year in their paychecks. The AEITC can give taxpayers both a paycheck “boost” while they’re working and a refund “bonus” when they file their return. There is no cost to employers. Employers reduce the amount of their required federal tax deposits by the advance payments and report the advance payments on Form 941. Taxes are not withheld from AEITC payments.

To qualify for and receive the AEITC in 2002, an employee must:

- 1) Complete [Form W-5](#), Earned Income Credit Advance Payment Certificate, and give it to the employer.

- 2) Expect to have at least one EITC qualifying child.
- 3) Expect to work and have earned income and adjusted gross income of less than \$28,000.
- 4) Have wages that are subject to Federal Income, Social Security, or Medicare tax withholding.
- 5) Expect to meet all the rules in the instructions for Form W-5 for the EITC for 2002.

Form W-5 contains additional information for married taxpayers, taxpayers with more than one job, and taxpayers whose situation changes during the year. Taxpayers who receive advance payments **must** file Form 1040 or Form 1040A for tax year 2002, even if they do not owe taxes for 2002.

Earned Income Tax Credit – Frequently Asked Questions and Answers

Q.) What are the earned income and adjusted gross income (AGI) limits for 2002?

A.) Claiming the EITC in 2002 depends on your client's filing status, earned income, and AGI. His/her earned income and AGI must each be less than:

Filing Status = Single or Head of Household

- \$33,178 with more than one qualifying child
- \$29,201 with one qualifying child
- \$11,060 without a qualifying child

Filing Status = Married Filing a Joint Return

- \$34,178 with two or more qualifying children
- \$30,201 with one qualifying child
- \$12,060 without a qualifying child

Q.) What are the most common reasons for disallowance of the EITC?

A.) Some of the more common reasons for disallowance are:

- Taxpayers claim a child who is not a qualifying child.
- Married taxpayers who should file as *married filing separately*, file as *single* or *head of household* instead.
- Income reporting errors.
- Taxpayers or qualifying children with mismatched or incorrect SSNs.

Q.) How can I determine whether a child meets the residency test?

A.) If you have any reason to question whether the child lived with the taxpayer for the required time period, you may find it useful to ask further questions. Additional questions might be necessary if, for example, the taxpayer states that the child lived with him or her for the entire year, but the taxpayer does not know the name of the child's school or care giver.

Q.) Must I review birth certificates to verify the age of the qualifying child?

A.) No. However, if you have reason to question the child's age, you may want to look at the birth certificate.

Q.) What can I do if I experience a significant number of rejects on electronically filed returns?

A.) If you experience a significant number of rejects, you should promptly discuss the situation with your local IRS Senior Tax Specialist in the Wage & Investment, Stakeholder Partnerships, Education and Communication Division, to identify and resolve any systemic problems. Call toll-free 1-800-691-1894 to locate the closest Tax Specialist.

Q.) What is EITC recertification?

A.) EITC recertification refers to the requirement that a taxpayer, whose EITC is denied or reduced for tax years starting after 1996 as a result of the deficiency procedures (upon examination), must attach a completed [Form 8862](#), Information To Claim Earned Income Credit After Disallowance, to the next tax return on which the taxpayer claims the EITC. For example, if a taxpayer's EITC for 2000 is denied before the taxpayer files a return for 2001, to claim the EITC for 2001, the taxpayer must attach Form 8862. If however, the taxpayer's 2000 claim is denied after the taxpayer files a return for 2001, but before the taxpayer files a return for 2002, Form 8862 is not required for 2001. However, Form 8862 must be attached to the return for 2002 if the taxpayer claims the EITC for that year. The recertification rules do not apply if the EITC was denied under the mathematical and clerical error procedures.

Q.) Is my client required to recertify when claiming the EITC for 2001?

A.) If the EITC was denied or reduced for any tax year starting after 1996, the taxpayer should have received Letter 3094, EIC Recertification Letter, from the IRS after the examination was completed. Letter 3094 explains the requirement to file Form 8862. Even though the taxpayer attaches a properly completed Form 8862 to the return for 2001, the taxpayer may still be required to furnish documentation before a refund is released.

Q.) Is my client prohibited from claiming the EITC for a number of years?

A.) Certain taxpayers may be prohibited from claiming the EITC for a two or ten year period. The prohibition may be imposed when the EITC claimed for a year after 1996 is denied or is reduced as a result of the deficiency procedures (upon examination), and the claim is determined to be due to reckless or intentional disregard of the EITC rules, or to fraud.

If the taxpayer's claim is due to reckless or intentional disregard of the EITC rules and regulations, that taxpayer will be prohibited from claiming the EITC for the next two years. As with the [Form 8862](#) requirement, the first year of prohibition is the first year for which a return has not yet been filed.

If the taxpayer is found to have fraudulently claimed the EITC, the taxpayer will be prohibited from claiming the EITC for the next ten years.

In both situations, after the prohibition period is over, the taxpayer must attach Form 8862 to the next return on which the taxpayer claims the EITC.

Q.) What do I need to do to meet the due diligence requirements of Section 6695(g) of the Internal Revenue Code (IRC) when preparing a return or claim for refund with the EITC?

A.) Preparers of EITC returns and claims for refund (whether paper or electronically filed) are expected to exercise due diligence in getting accurate information to determine eligibility and in correctly computing the EITC amount. To meet your due diligence requirements, you must:

- Complete [Form 8867](#), Paid Preparer's Earned Income Credit Checklist, or otherwise record the information necessary to complete Form 8867 in your paper or electronic files (alternative checklist);
- Complete the appropriate earned income credit worksheet in the instructions for Form 1040, 1040A, 1040EZ, or in [Publication 596](#), Earned Income Credit, or otherwise record the information necessary to complete the appropriate worksheet in your paper or electronic files (alternative worksheet);
- Have no knowledge or reason to know that any information you use in determining eligibility for, and the amount of, the EITC is incorrect; and
- Retain a copy of Form 8867 and the appropriate worksheets (or their alternatives) for three years after June 30th following the date the return or claim for refund was presented to the taxpayer.

A preparer may use electronic formats and may retain the records on paper or electronically.

A preparer may not satisfy the knowledge requirements by ignoring the implications of information furnished to, or known by him. If any information furnished to, or known by the preparer appears to be incorrect, inconsistent, or incomplete, the preparer must make reasonable inquiries to resolve the matter and determine whether the taxpayer is entitled to claim the EITC or the proper amount of the EITC.

Q.) What is the effect of the new tie-breaker rules on the due diligence requirements?

A.) Paid preparers are responsible for informing their clients about and applying the tie-breaker rules. If the preparer learns that another taxpayer with a superior right to claim the credit based on the child has already done so, or intends to do so, the preparer may not prepare the taxpayer's return without being subject to a penalty. However, if the taxpayer has the superior right, the preparer may prepare the taxpayer's return, even though the preparer knows that someone with an inferior right has already claimed the credit based on the child.

Q.) Must I use Form 8867, Paid Preparer's Earned Income Credit Checklist, as part of the due diligence process?

A.) No. It is not necessary to use [Form 8867](#) to meet the preparer due diligence requirements. However, you must either use Form 8867 or otherwise record the information necessary to complete Form 8867 in your paper or electronic files. Your electronic record must meet the requirements of Revenue Procedure 97-22, 1997-1 C.B. 652.

Q.) Is there a penalty for not meeting the preparer due diligence requirements?

A.) Yes. Failure to meet the preparer due diligence requirements could result in a \$100 penalty for each failure under IRC Section 6695(g). However, you may avoid the penalty with respect to a particular return or claim for refund if you can demonstrate to the satisfaction of the IRS that, given all the facts and circumstances, your normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements discussed above, and the failure to meet due diligence requirements with respect to the particular return or claim for refund was isolated and inadvertent.

Q.) Must taxpayers and qualifying children all have SSNs?

A.) Yes. There are several types of taxpayer identification numbers that can be used when filing a federal tax return, but only an SSN can be used when claiming the EITC. However, if a Social Security card says "Not Valid for Employment," the SSN generally cannot be used when claiming the EITC.

Q.) How can I tell if my clients and their children have the right kind of SSNs?

A.) If the Social Security card does not contain the legend "Not Valid for Employment," then the number can be used for EITC purposes. All U.S. citizens and all aliens granted permanent resident status are entitled to receive an SSN from the SSA. Aliens who do not have permanent resident status generally cannot get an SSN unless they are entitled to certain federally funded benefits. Their Social Security cards are issued with the words "Not Valid for Employment," on the front of the card.

Q.) Must I review Social Security cards?

A.) No. However, because the IRS uses SSNs to identify taxpayers, it is important that you explain to your clients that all names must appear on the return exactly as they appear on the Social Security card.

Q.) How can I avoid mismatches of SSNs?

A.) One of the primary reasons for the rejection of a return or a delay in processing a return is an incorrect SSN. It is important that you check the accuracy of each SSN, as well as the spelling of the name associated with the number. Ask if your client received a notice of an incorrect SSN for any prior tax year.

Q.) If there is a mismatch, what can I do to help?

A.) If the problem is not yet resolved:

- Have your client check the Social Security card for accuracy of the name and number on the return.
- Ask if a name or other change has been reported to the SSA.
- Determine if the problem was due to an error in recording or transcribing the number.
- Refer your client to the SSA to resolve the problem before filing a return if you cannot determine the problem.

Q.) Where can I learn more about surname entry formats?

A.) A detailed discussion of surname entry formats can be found in [Publication 1346](#), Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns. The specific references are in Part 1, Section 7 – Formats for Name Controls, Name Lines, and Addresses. If your software product “interprets” the name control from entries in the full name field, entries in the full name field should also conform to the name control format.

Q.) How do I report my suspicion if I think a client or another preparer is doing something questionable?

A.) As a tax professional, you have a vested interest (both as a taxpayer and as a tax preparer) in the protection of the tax filing system. Report your suspicions by sending an e-mail to the IRS Office of Refund Crimes at HQ-ORF@ci.irs.gov or by calling 1-800-829-0433.

You can also file Form 211, Application for Reward for Original Information, if you want to be considered for a reward for information leading to the detection of violations of the IRC.